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RUCNARF/ASEAN REGIONAL FORUM COLLECTIVE PRIORITY
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RUEATRS/DEPT OF TREASURY WASHINGTON DC PRIORITY
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UNCLAS SECTION 01 OF 03 KUALA LUMPUR 001063

SENSITIVE
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DEPT FOR EEB/TPP/BTA AND EAP/MTS,
TREASURY FOR OASIA AND IRS,
STATE PASS FOR USTR - WEISEL AND BELL,
STATE PASS FOR FEDERAL RESERVE AND EXIMBANK,
STATE FOR FEDERAL RESERVE SAN FRANCISCO TCCURRAN,
USDOC FOR 4430/MAC/EAP/J.BAKER,
USDA FAS FOR OA/BIG, ITP/AAD,
COMMERCE FOR 4430/MAC/MICHAEL HOGGE,
GENEVA FOR USTR

E.O. 12958: N/A
TAGS: ECON EFIN ETRD EINV MY
SUBJECT: MALAYSIA: VIEWS ON ECONOMY TURN NEGATIVE

¶1. (SBU) Summary: The central bank of Malaysia released a relatively upbeat report on third quarter economic performance November 28, highlighting GDP growth of 4.7 percent despite deteriorating global economic conditions. The central bank acknowledged that Malaysia, as a highly open economy, would be impacted by external factors going forward. Members of the U.S. business community have told the Ambassador in several recent meetings that economic conditions in Malaysia have worsened considerably since the beginning of the fourth quarter and they are concerned that the government,s pronouncements about the economy would play poorly with the public when the real depth of the problems Malaysia faces become clear. Export orders, which weakened significantly in the third quarter, have fallen dramatically, according to U.S. business executives, and demand for products in the domestic market were falling along with investment in core areas of the economy like energy and manufacturing. The cental bank Governor told US bankers in mid-November the government was aware of this sharp downturn and was prepared to act as necessary to support economic growth. The central bank lowered the benchmark interest rate on November 24, and a central bank official told Econcouns December 2 it had lowered its in-house forecast for GDP growth in 2009 to 2.5 percent and its real concern was that the policy tools available to the government could only partially offset the impact of falling external demand on the economy. End Summary.

¶2. (SBU) Comment: The government of Malaysia faces two problems: a sharp economic downturn and a longstanding need to make difficult economic reforms required to improve the economy's efficiency and competitiveness. The government has used appropriate fiscal stimulus and monetary easing to smooth out the shock that the financial crisis represents, and Deputy PM Najib has said many of the right things about the need for international cooperation to address the global economic crisis, including rejecting protectionism. Still, with the economy facing a significant slowdown, the government of Malaysia will face hard political choices over whether it will stick with the economic policy status quo or dismantle its own trade and investment barriers that hinder growth. These economic problems come in the midst of an election cycle for the ruling UMNO party, and also come at a time of increased opposition challenge, factors that

encourage Malaysian government leaders to be overly positive in their public economic assessments and to seek short term fixes over politically difficult reforms. Adjustments that touch on race-based preferences will be a praticularly sensitive area at this moment, as racial rhetoric between UMNO and its Malay partners has intensified. End Comment.

Upbeat Assessment by Central Bank

¶3. (SBU) Bank Negara (BN), Malaysia,s central bank, gave a relatively upbeat assessment to third quarter economic figures released on November 28, highlighting a slowing but reasonably resilient economy. GDP growth had slowed from 8.3 percent in Q2 to 4.7 percent in Q3, drawn lower by lower fixed capital formation and FDI in the face of cautious business sentiment. BN noted relatively strong Q3 export numbers were supported by high prices, but chose not to point out that with prices of key commodities falling and export orders drying up; future prospects would be significantly gloomier.

Gloomy U.S. Business Views

¶4. (SBU) In recent AmCham briefings with the Ambassador, U.S. business leaders emphasized that economic conditions in Malaysia had taken a decided turn for the worse during the month of November and that the government,s &happy talk8 on the economy which focused on previous performance could turn out to be counterproductive as the public became aware of the difficulties ahead. Firms like 3M that have a real-time read on shifts in domestic demand, said orders from

local firms had fallen off a cliff since the end of October. Dell also reported dramatic cuts in IT orders from local customers. Other U.S. firms were even more pessimistic. Intel and Linear Technologies representatives indicated that export orders had dried up, that some customers could not obtain trade financing and that most firms were looking at ways to cut back operational costs, including extended leave or layoffs for employees, to weather the downturn. Energy firms like ExxonMobil and Murphy Oil said investment projects were either being put on hold or cut back. PriceWaterhouseCooper, which provides advice to a wide selection of foreign firms, concurred with the assessment that there is a pullback on business investment across-the-board.

¶5. (SBU) Despite relaying these same concerns to government leaders, the head of a major U.S. banking firm said key players like the Second Finance Minister Yakcop just did not seem to get the seriousness of the situation Malaysia faced. According to this contact, Yakcop held a roundtable of business leaders following the announcement of the fiscal stimulus package to see what additional steps the government could take to support economic growth and FDI flows, but when the foreign firms provided concrete suggestions to stimulate investment in the services sector, Yakcop responded with a long-winded answer on the difficulty involved that left little room for optimism.

¶6. (SBU) Another senior AmCham board member and long-time resident/observer of the Malaysian economic and political scene, told the Ambassador that this was yet another example of the GOM demonstrating it was adept at snatching defeat from the jaws of victory. The economic crisis provided an opportunity to move on reforms, but partly due to a lack of confidence and competence in government, leaders were failing to move. While the political leadership transition was contributing to the lack of action, he said that Malaysia,s incremental approach to policy was ingrained and the leadership was simply not open to the large scale reform measures Malaysia needed to look ahead and reinvent itself to maintain competitiveness. Malaysian leaders lacked the courage and vision to take big reforms. In addition to the financial crisis, Malaysia faced an energy crisis and a

fiscal crisis a few years down the road, but despite much discussion, the government had yet to devise policies to deal with these challenges. This observer added that this inaction continued even though government leaders were aware that Malaysia,s position as a key site for electronics industry FDI was already mostly a thing of the past and that several important U.S. firms that had been mainstays in Malaysia had already pulled out. Speaking to this point, a country manager of a major U.S. oil services company said his firm would have done an expansion of its facility in Johor, but found the government too difficult, slow and cumbersome, and therefore redirected investment funds to Singapore.

¶7. (SBU) According to a senior U.S. banker, Bank Negara Governor Zeti admitted the government,s public stance on the economy was overly positive but she asserted that the government was not unaware or in denial about the worsening condition of the economy. She acknowledged that political leaders should be less optimistic in their public comments but she had no control over that. In general, Zeti said, the government was trying to maintain a realistic framework by announcing downward revisions in the GDP growth forecast without becoming alarmist. Citi said the bankers told Zeti the government was risking an unpleasant shock to the public when it became clear that the economy was doing much worse next year than the government is letting on. However, a senior Bank Negara official told Econcouns December 2 that the government felt strongly it had to manage carefully the flow of negative information to prevent self-fulfilling negative expectations or panics that could cause additional damage to the economy. This official said Bank Negara,s in-house estimates for GDP growth for 2009 already had been

revised downward to 2.5 percent, and that the government was looking at all policy options, but fiscal and monetary tools, while somewhat helpful, could not fend off a slowdown brought on by declining global demand.

KEITH